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IN THE

Supreme Court of the United States

October Term, 1975

No. 75-900

MINNESOTA GAS COMPANY, a Delaware corporation,
Petitioner,

vs.

PUBLIC SERVICE COMMISSION, Department of Public Service, State of Minnesota,

and

CITY OF MINNEAPOLIS, State of Minnesota,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Minnesota Gas Company respectfully petitions this Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eighth Circuit, by Judge Donald P. Lay, is reported in 523 F.2d 581, and is reproduced in the Appendix hereto, beginning at p. A-1.

The opinion of the United States District Court, District of Minnesota, Fourth Division, by Judge Earl R. Larson, has not been reported, but is reproduced in the Appendix hereto, beginning at p. A-9.

JURISDICTION

The decision of the United States Court of Appeals for the Eighth Circuit was filed and judgment was entered on September 26, 1975. Petition for rehearing was then timely filed, but was denied, without opinion, on October 21, 1975.

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1254(1).

QUESTIONS PRESENTED FOR REVIEW

1. May a state legislature enact and enforce legislation which by its terms abrogates contract rights absent a showing of (a) a legitimate public purpose for the abrogation and (b) that the abrogation is reasonable and appropriate to that public purpose, in the face of the decisions of the United States Supreme Court which require that the police power of the state be balanced and construed in harmony with the Contract Clause of the United States Constitution.

2. Does the state have the power to enact and enforce legislation dealing with a police power function which its agent (municipality) has effectively suspended for a limited term by a contract with a private corporation expressly authorized by the state.

CONSTITUTIONAL AND STATUTORY PROVISIONS

United States Constitution, Article 1, Section 10 provides in pertinent part:

> "No state shall . . . pass any . . . law impairing the obligation of contracts. . . ."

Section 36 of the Minnesota Public Utilities Act, Minnesota Laws 1974, Chapter 429 (coded as Minn. Stat. §216B.36) provides, in pertinent part, as follows:

> "Sec. 36. Franchises Continued.
>
> . . . All existing licenses, permits, franchises and other rights acquired by any public utility or municipality prior to the passage of laws 1974, Chapter 429 including the payment of existing franchise fees, shall not be impaired or affected in any respect by the passage of this Act, except with respect to matters of rate and service regulation and service area assignments that have been vested to the jurisdiction of the Commission by laws 1974, Chapter 429."

STATEMENT OF THE CASE

The facts are not in dispute.

Petitioner Minnesota Gas Company ("Company") is a natural gas distribution utility serving 130 Minnesota communities. Respondent Public Service Commission is a branch of the Minnesota Department of Public Service and, pursuant to the Minnesota Public Utilities Act which was passed by the Minnesota Legislature and became law on April 12, 1974 (Minn. Stat. §§216B.01-216B.67), is vested with the power and has the duty to regulate investor-owned and cooperatively-owned electric and gas utilities.

The Company is subject to the Act as a investor-owned utility furnishing retail gas service to the public.

From September 1966, through December 1969, the City of Minneapolis ("City") and the Company negotiated the terms of a franchise contract to cover the Company's operations in the City. The franchise was adopted by the City on December 29, 1969, accepted by the Company on the next day, and became effective on January 1, 1970 for a 25-year term. One of the principal terms of that franchise contract is a maximum rate formula which operates to adjust the maximum rates which the Company may charge, to reflect changes in the necessary costs of providing gas service to the City and to permit the Company to earn a six and one-half percent return on its property used and useful in providing service. Many additional terms treat and define the economic relationship between the City and the Company.

The Company had the power to enter into the franchise contract and the City was expressly authorized by the State to contract as to the Company's rates. The validity of the 1970 Franchise Contract is conceded.

The Minnesota Public Utilities Act, at §36 (Minn. Stat. 216B.36), expressly abrogated the 1970 Franchise Contract insofar as it provided for the establishment of maximum rates for natural gas service by the Company in the City.

In June, 1974 the Company commenced its action in the United States District Court for Minnesota for a declaratory judgment that §36 of the Act of the Minnesota Public Utilities Act, to the extent that it purported to abrogate the rate provisions and thereby impair the obligations of the 1970 Franchise Contract, was unconstitutional and void under the Contract Clause and the Due Process Clause of

the Fourteenth Amendment of the United States Constitution. The City joined in and supported the Company's position on the unconstitutionality of §36 of the Act.

The matter was argued and submitted in November, 1974 to District Judge Earl R. Larson on the Commission's motion to dismiss for failure to state a claim. In December, 1974 Judge Larson granted that motion and upheld the constitutionality of §36 of the Act.

The case was then timely appealed to the United States Court of Appeals for the Eighth Circuit where the decision of the District Court was affirmed.

Jurisdiction of the District Court was based upon 28 U.S.C. §1331 in that the action arose under the United States Constitution and the amount in controversy exceeds $10,000. Jurisdiction of the Court of Appeals was grounded in 28 U.S.C. §1291.

ARGUMENT

I.

THE DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT CONFLICTS WITH THE APPLICABLE DECISIONS OF THIS COURT WHICH HOLD THAT THE VALIDITY OF STATE LEGISLATION MODIFYING OR ABROGATING THE OBLIGATION OF CONTRACT DEPENDS ON WHETHER THE LEGISLATION IS ADDRESSED TO A LEGITIMATE END AND THE MEASURES TAKEN ARE REASONABLE AND APPROPRIATE TO THAT END.

The issue in this case must be analyzed in the context of a state law destroying rights granted and obligations assumed in a valid, pre-existing contract. This analysis was begun by the Court of Appeals (523 F.2d at 585) but was never completed.

Specifically, the court recognized that *City of El Paso v. Simmons*, 379 U.S. 497 and *Home Building and Loan Association v. Blaisdell*, 290 U.S. 398 require that state legislation challenged under the Contract Clause and the Due Process Clause of the Fourteenth Amendment must, to be upheld, "be for a legitimate public purpose under the police powers and . . . the means adopted be reasonable and appropriate to the end in view." (523 F.2d at 585.)

The Court of Appeals, by failing to apply this dual test, construed the state's reserved police power to be absolute and destroyed the constitutional limitation of the Contract Clause, in direct conflict with the applicable decisions of this Court.

The decisions of this Court are clear that neither the Contract Clause nor the police power are without limit. The Contract Clause is not an absolute prohibition and the police power must be exercised consistently with the fair intent of the Contract Clause. The two conflicting principles must be balanced if both are to retain significance. This necessity was recognized in *El Paso v. Simmons*, 379 U.S. at 509, where this Court quoted from the *Blaisdell* case:

> "[W]hatever is reserved of state power must be consistent with the fair intent of the constitutional limitation of that power. The reserved power cannot be construed so as to destroy the limitation, nor is the limitation to be construed to destroy the reserved power in its essential aspects. They must be construed in harmony with each other. This principle precludes a construction which would permit the state to adopt as its policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them."

While the Court of Appeals recognized the necessity of balancing the protection of the Contract Clause with the essential attributes of the reserved police power, it failed to do so. The court simply failed to measure the challenged legislation against the constitutional standard it recognized. The very basic balancing of the limitation and the power is totally absent.

Sound and important reasons exist for the granting of certiorari in this case. These reasons are found in attempting to answer the question of whether, under the decision of the Court of Appeals, the Contract Clause still exists as a viable concept which will, in any degree, limit the exercise of a state's reserved police power. This Court in *El Paso* (379 U.S. at 508) quoted from *Blaisdell* (290 U.S. at 435) to show that the principle of harmonizing the constitutional prohibition of the Contract Clause with the essential aspects of a state's reserved power has had "progressive recognition" over the years.

The decision of the Court of Appeals, however, did not follow the principle as recognized in the applicable decisions of this Court. Instead, it went all the way and construed the state's reserved police power to be supreme and without constitutional limitation.

To permit the Court of Appeals decision to stand is to permit a precedent which not only conflicts with the clear teachings of *El Paso* and *Blaisdell* but also creates the clear danger of subsequent decisions within this and other circuits upholding similar exercises of the state which render the Contract Clause meaningless by completely destroying the constitutional limitation.

Certiorari should be granted so that this Court can determine what protection, if any, is provided today by the

Contract Clause against state legislation expressly abrogating valid rights under pre-existing contracts. Should *El Paso* be read, as the Court of Appeals has read it, to allow state legislation abrogating contractual rights to be upheld *without* any evidence or finding that the legislation is directed to a legitimate end and *without* any evidence or finding that the abrogation is reasonable and appropriate action under the circumstances? If so, the requirement of harmonizing or balancing the two principles has ceased to exist. If that be the case, this Court and not the Court of Appeals should make that change in the fundamental law of the land.

In evaluating the importance of this case for certiorari, a distinction must be drawn between the validity of the general regulatory scheme in the Minnesota Public Utilities Act, on the one hand, and the validity of the abrogation clause of §36, on the other. The public purpose to be accomplished by the general regulatory scheme is found in §1 of the Act, *Minn. Stat.* §216B.01:

> "216B.01 Legislative finding
>
> It is hereby declared to be in the public interest that public utilities be regulated as hereinafter provided in order to provide the retail consumers of natural gas and electric service in this state with adequate and reliable services at reasonable rates, consistent with the financial and economic requirements of public utilities and their need to construct facilities to provide such services or to otherwise obtain energy supplies, to avoid unnecessary duplication of facilities which increase the cost of service to the consumer and to minimize disputes between public utilities which may result in inconvenience or diminish efficiency in service to the consumers. Because municipal utilities

> the presently effectively regulated by the residents of the municipalities which own and operate them, it is deemed unnecessary to subject such utilities to regulation under Laws 1974, Chapter 429 except as specifically provided herein."

This legislative finding shows that the regulatory process is to benefit the retail consumers of gas and electricity in Minnesota by regulating the unregulated gas and electric utilities. Municipal utilities were excluded from most of the regulatory provisions of the Act because they "are presently effectively regulated by the residents of the municipalities which own and operate them."

The Company concedes that the general scheme of regulation in the Act is valid because it is addressed to a legitimate end and contains reasonable and appropriate measures to accomplish that end. The validity of the Act in general is not in issue.

This is not true, however, as to the abrogation clause of §36. There is no showing whatsoever, either that a legitimate public purpose would be served by the abrogation clause or that it was reasonable or appropriate to the legitimate end of the legislation.

More than one-half of the opinion in *El Paso* is devoted to a recitation of the serious and extensive problems, affecting title to some 42 million acres of once state-owned lands, which the 1941 five-year reinstatement act was designed to solve. This Court judged the validity of the 1941 statute in light of the specific problems confronting the State of Texas at the time (379 U.S. at 513) and held that the legislation was necessary to protect vital interests of the state.

In this case, there is no showing of any public motive,

policy or objective to support and justify the exercise of the state's reserved power to abrogate the maximum rate provisions of the 1970 Franchise Contract. The available evidence supports the maintenance of the contract, not its abrogation: the Company's rates in the City were subject to effective and detailed control under the Franchise Contract and abrogation of it was not needed to protect the public from excessive or uncontrolled rates; the City was a party to this case and urged the District Court to uphold the Franchise Contract.

The short statement of legislative finding, couched in broad, sweeping terms, clearly does not, either expressly or impliedly, constitute the legitimate purpose needed to counterbalance the constitutional limitation of the Contract Clause under the decisions of this Court.

Certainly, uniformity of regulation cannot be relied upon. The Act, by its terms, does not provide for uniform regulation of all electric and gas utilities: municipal electric and gas utilities are excluded from most of the Act; cooperatively owned utilities are treated differently than privately owned utilities; and, gas utilities are not treated the same as electric utilities.

If the Contract Clause is still important as a limitation on the reserved police power of a state, then this case is so important that certiorari should be granted.

II.

THE DECISION OF THE COURT OF APPEALS OVERRULES LONGSTANDING CONTROLLING PRECEDENT OF THIS COURT WHICH HOLDS THAT THE RESERVED POLICE POWER OF THE STATE IS SUSPENDED DURING THE REASONABLE TERM OF A BINDING RATE CONTRACT BETWEEN A UTILITY AND A MUNICIPALITY WHICH WAS EXPRESSLY AUTHORIZED BY THE STATE.

The ruling principle of law relied upon by the Company to support its claim that the abrogation clause of §36 of the Minnesota Public Utilities Act is unconstitutional as applied to the 1970 Franchise Contract was stated in *St. Cloud Public Service Co. v. City of St. Cloud,* 265 U.S. 352, 354-55, as follows:

> "It has been long settled that a state may authorize a municipal corporation to establish by an inviolable contract the rates to be charged by a public service corporation **for a definite term,** not grossly unreasonable in time, and that the effect of such a contract is to suspend, during its life, the governmental power of fixing and regulating the rates. Home Teleph. Co. v. Los Angeles, 211 U. S. 265, 273, 53 L. ed. 176, 182, 29 Sup. Ct. Rep. 50, and cases there cited. And where a public service corporation and the municipality have power to contract as to rates, and exert that power by fixing the rates to govern during a particular time, the enforcement of such rates is controlled by the obligation resulting from the contract. . . ."

St. Cloud held that such a contract could not be changed by the utility. *Minneapolis v. Minneapolis Street Railway Co.,* 215 U.S. 417, held that such a contract could not be changed by a municipal ordinance exercising the munici-

pality's regulatory power. *Superior Water, Light and Power Co. v. Superior,* 263 U.S. 125, held that such a contract could not be changed by a state law exercising the state's reserved police power.

The 1970 Franchise Contract meets the requirements of the *St. Cloud* case: the State authorized the City to make the contract; a binding contract as to rates was, in fact, made between the City and the Company; the contract was for a reasonable term. Its effect, therefore, was to suspend, during its life, the State's reserved governmental power of fixing and regulating the Company's rates in the City.

In harmonizing the state's exercise of its reserved police power with the limitation of the Contract Clause in this case —in balancing the two opposing concepts—the previous decisions of this Court in *St. Cloud, Minneapolis Street Railway* and *Superior Water, supra,* require that the 1970 Franchise Contract be upheld against the abrogation clause of §36 of the Public Utilities Act.

This result obtains because the state expressly authorized its agent (municipality) to make the contract and it would be completely unreasonable and inappropriate for the state to attempt now to withdraw that authority and destroy the contract previously made in reliance thereon.

There is no showing whatsoever in this case of any legitimate public purpose which required the state to reverse its position and abrogate a contract which it previously authorized the City to make.

The Court of Appeals misapprehended the applicability of the *St. Cloud* case and overlooked the applicability of the *Superior Water* case.

The court mistakenly read *St. Cloud* to require that a municipality must have the authority from the state to regu-

late the utility's rates *as well as* the expressly granted authority from the state to contract for them, in order to create a contract which would withstand abrogation by subsequent state legislation enacted under its reserved police power (523 F. 2d at 584). This is not the holding of the *St. Cloud* case. In *St. Cloud* the power of the municipality to regulate was not a prerequisite to the creation of a rate contract which would suspend during its reasonable term the reserved governmental power of fixing and regulating the rates.

In *St. Cloud* this Court held that the existence of the power to regulate *does not preclude* the power to contract (265 U.S. at 359-60).

The Court of Appeals completely overlooked or ignored, the *Superior Water* case when it stated (523 F. 2d at 585):

> "In this case the State was not a party to the contract."

This statement, while factually correct, has no legal significance because of *Superior Water*. If the contract was expressly authorized by the state, *Superior Water* dictates (263 U.S. at 137) that the state cannot thereafter change its terms.

The 1970 Franchise Contract is entitled to the protection of the Contract Clause under the long-standing applicable decisions of this Court cited in this section of argument. The City and the Company acted in good faith in making the contract and were entitled to act in reliance on these decisions. If these cases no longer represent the law, that decision should be made by this Court to operate prospectively and not by the Court of Appeals to operate retroactively.

This Court should grant certiorari on this point to resolve the important question whether its applicable decisions are still controlling on the issue presented or whether the decision of the Court of Appeals now states the law.

CONCLUSION

The State of Minnesota had expressly authorized the City to contract with the Company for gas rates in the City. The contract was negotiated and agreed upon in reliance on that authority. The State now, acting under its reserved police power, has destroyed the heart of the contract by enacting the abrogation clause of §36 of the Minnesota Public Utilities Act.

This action by the State was upheld by the Court of Appeals in a decision which:

> (1) upheld the exercise of the reserved power without *any* showing of the legitimate end to be served by the abrogation of the contract and without *any* showing that the abrogation was reasonable or appropriate to any legitimate public purpose; and
>
> (2) permitted the abrogation clause to destroy the rate provisions of the 1970 Franchise Contract notwithstanding that the City had been expressly authorized by the State to make an inviolable contract on the subject and a valid contract was, in fact, so made for a definite term, not unreasonable in time.

This Court should grant certiorari in this case so that it can review and determine whether the Contract Clause remains as a viable constitutional limitation on the exercise of a state's reserved governmental power; and if it does

still exist, whether the requirement of balancing or harmonizing the two opposing concepts has changed or been eliminated since this Court's decision in the *El Paso* case.

This Court should grant certiorari, and the judgment below should be reversed.

Respectfully submitted,

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December 22, 1975

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

NO. 75-1061

MINNESOTA GAS COMPANY, a Delaware Corporation,

Plaintiff-Appellant,

vs.

PUBLIC SERVICE COMMISSION, DEPARTMENT OF PUBLIC SERVICE, STATE OF MINNESOTA,

Defendant-Appellee,

and

CITY OF MINNEAPOLIS, STATE OF MINNESOTA,

Defendant.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MINNESOTA.

Submitted: June 10, 1975
Filed: September 26,

Before VAN OOSTERHOUT, Senior Circuit Judge, LAY and HEANEY, Circuit Judges.

LAY, Circuit Judge.

The Minnesota Gas Company (Minnegasco) filed this action seeking a declaratory judgment that a recently enacted Minnesota statute is unconstitutional insofar as it purports to permit a state agency to prescribe utility rates different from those set out in a preexisting utility franchise

contract between Minnegasco and the City of Minneapolis. The district court, the Hon. Earl Larson presiding, dismissed the claim on the ground that the State had reserved power to regulate utility rates and that the interference with Minnegasco's contract did not violate the Constitution. We agree and affirm essentially for the reasons set forth in the district court's unreported memorandum opinion.[1]

In 1969 Minnegasco entered into a franchise contract with the City of Minneapolis under which the utility was

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[1]Although the Commission has not yet attempted to change the rates charged by Minnegasco under its contract, the district court found the controversy "ripe" for adjudication because the presence of presumptive authority to alter the rates interferes with Minnegasco's longterm financial planning and performances under the contract. *See Public Util. Comm'n. v. United States,* 355 U.S. 534 (1958).

At oral argument this court on its own motion questioned whether the Johnson Act of 1934, 28 U.S.C.A. § 1342, deprived the federal courts of jurisdiction in this matter. The Act provides:

> The district courts shall not enjoin, suspend or restrain the operation of, or compliance with, any order affecting rates chargeable by a public utility and made by a State administrative agency or a rate-making body of a State political subdivision, where:
>
> (1) Jurisdiction is based solely on diversity of citizenship or repugnance of the order to the Federal Constitution; and,
>
> (2) The order does not interfere with interstate commerce; and,
>
> (3) The order has been made after reasonable notice and hearing; and,
>
> (4) A plain, speedy and efficient remedy may be had in the courts of such State.

The Johnson Act was recently held by the Tenth Circuit to prohibit federal courts from entertaining suits for declaratory relief as well as injunctions against state rate orders. *Tennyson v. Gas Serv. Co.,* 506 F.2d 1135, 1139 (10th Cir. 1974). However, in the present case Minnegasco is not challenging a particular administrative *order affecting rates* but rather a *Minnesota statute* asserting the power to regulate in general. Where the constitutional challenge is to the State's power to regulate *per se* rather than to the procedural and substantive fairness of an administrative order, the Johnson Act has been held inapplicable. *Public Util. Comm'n. v. United States,* 355 U.S. 534, 540 (1958).

given the exclusive right to provide natural gas service to the City and its inhabitants for 25 years. The contract allowed Minnegasco to set rates annually to insure a 6 1/2% return on investment. In 1974 the Minnesota legislature enacted Minn. Stat. § 216B, the Minnesota Public Utilities Act, which created a Public Service Commission to set rates for and otherwise regulate privately owned utility companies. Section 36 of the Act expressly provides that rates set by the Commission will supersede those provided in existing utility franchise contracts.

The fundamental question is whether either the Contracts Clause or the Fourteenth Amendment Due Process Clause prohibits a State from setting reasonable utility rates which will supersede those specified in a preexisting contract between a municipality and a privately owned utility company. Clearly, if neither party were a governmental subdivision, no serious federal question would be presented. Regulation of public utility rates has long been held an area of public interest subect to State police power legislation, *Block v. Hirsh*, 256 U.S. 135, 157 (1921); *Munn v. Illinois*, 94 U.S. 113 (1876). It is an implied condition of all private contracts in such areas of public interest that the agreement is subject to frustration by subsequent legitimate exercises of the State's police power. Thus, private parties cannot by contract insulate themselves from State rate regulations adopted thereafter. As the Supreme Court stated in *Union Dry Goods Co. v. Georgia Public Service Corp.*, 248 U.S. 372 (1919):

> That private contract rights must yield to the public welfare, where the latter is appropriately declared and defined and the two conflict, has been often decided by this court. Thus, in *Manigault v. Springs*, 199 U.S.

473, 480, it was declared that:

> "It is the settled law of this court that the interdiction of statutes impairing the obligation of contracts does not prevent the State from properly exercising such powers as are vested in it for the promotion of the common weal, or are necessary for the general good of the public, though contracts previously entered into between individuals may thereby be affected." . . .

248 U.S. at 375.

Minnegasco urges, however, that a different result is mandated here since one of the parties to the contract was a municipality, a political subdivision of the State. The utility argues that the State empowered the City to enter into *inviolable* contracts for utility rates, and that the effect of such a contract is to suspend the State's regulatory power within the City during the life of the contract. In effect, Minnegasco's view is that the City signed the contract as an agent of the State, that the State must be viewed as a party to the agreement and hence is bound by its terms. We cannot agree.

Minnegasco relies on the Supreme Court's decision in *St. Cloud Public Service Co. v. City of St. Cloud*, 265 U.S. 352 (1924). In that case, the State had granted the City of St. Cloud both the power to contract for rates and the power to regulate them by ordinance. The City chose to contract for rates. When rising costs made the contract unprofitable for the utility, it sought to avoid the contract as unreasonable and confiscatory under the Fourteenth Amendment. The Supreme Court held that since the City had proceeded by contract rather than by legislation, no Fourteenth

Amendment problem was presented, and it upheld the contract against the utility's efforts to secure a rate increase. The Supreme Court did say in *St. Cloud* that:

> [W]here a municipality has both the power to contract as to rates and also the power to prescribe rates from time to time, if it exercises the power to contract, *its* power to regulate the rates during the period of the contract is thereby suspended, and the contract is binding.

265 U.S. at 360 (our emphasis).

We do not think *St. Cloud* is helpful here, however, for Minnegasco concedes that the State did not delegate to Minneapolis its police power to *regulate* rates; the City had only the power to contract for rates. A Minnesota statute in effect both when the City's home rule charter was granted in 1920 and when the franchise contract was negotiated in 1969 reserved the power to regulate utility rates to the State. The statute provides:

> The state shall at all times have the right to supervise and regulate the business methods and management of any [public utility] corporations and *from time to time to fix the compensation which it may charge or receive for its services.*

Minn. Stat. Ann. § 300.04 (emphasis added).

Whether the power to contract given the City in its charter includes the right to make invoilable rate contracts suspending the State's regulatory power is a matter controlled by Minnesota law. The Minnesota Supreme Court has stated that a purported grant of such a power must be clear-

ly expressed and that so great a restriction on State police powers will not be implied.

> The power to fix rates charged by public utilities rests primarily with the state rather than the municipality, and in the absence of a constitutional provision, the power to fix or regulate such rates may be delegated by the state to municipal corporations. But the grant to a municipality of the power to make an *inviolable contract* for rates must be in clear and unequivocal terms and the intent to make such grant of power will not be implied.

Western States Utilities Co. v. City of Waseca, 242 Minn. 302, 65 N.W. 2d 255, 263 (1954) (emphasis original).[2]

Under the circumstances, the City's exercise of its right to contract had no different effect than the entry of a private citizen into such a contract; it did not suspend the State's police power to set reasonable utility rates. The City acted in its proprietary, rather than its governmental capacity. *Reed v. City of Anoka*, 85 Minn. 294, 88 N.W. 981 (1902). Under Minnesota law, its contract was subject to subsequent police power legislation.

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[2]As the district court noted, the Supreme Court in *Home Tel. & Tel. Co. v. City of Los Angeles*, 211 U.S.265 (1908) observed:

> It has been settled by this court that the State may authorize one of its municipal corporations to establish by an inviolable contract the rates to be charged by a public service corporation (or natural person) for a definite term not grossly unreasonable in point of time, and that the effect of such a contract is to suspend, during the life of the contract, the governmental power of fixing and regulating the rates. . . . But for the very reason that such a contract has the effect of extinguishing *pro tanto* an undoubted power of government, both its existence and the authority to make it must clearly and unmistakably appear, and all doubts must be resolved in favor of the continuance of the power.

211 U.S. at 273.

> It is well settled that every contract is subject to the implied condition that its fulfillment may be frustrated by a proper exercise of the police power. Of course, such exercise of that power must be for an end which is in fact public and the means adopted must be reasonably adapted to that end. *The same is true of legislation impairing the obligations of a contract of state instrumentality.*

Western States Util. Co. v. City of Waseca, supra, at 261 (emphasis added).

The same result obtains under the Federal Constitution. In *City of El Paso v. Simmons,* 379 U.S. 497 (1965), the Supreme Court considered a Texas statute reducing to five years the previously unlimited right of reinstatement after forfeiture on contracts for land sold by the State. The plaintiff, who sought to redeem land purchased before enactment of the statute, claimed an unconstitutional impairment of his contract. The Supreme Court upheld the statute. Although the State was clearly a party to the land contract, the Court evaluated the legislation under the Contracts and Due Process Clauses using the same test as if the contract had been between private parties. 379 U.S. at 506-09. That test was set out by Chief Justice Hughes in *Home Building & Loan Ass'n. v. Blaisdell,* 290 U.S. 398 (1934), and requires that the legislation be for a legitimate public purpose under the police powers, and that the means adopted be reasonable and appropriate to the end in view. 290 U.S. at 438. There too, the Chief Justice noted that all contracts, private and public, are subject to the reserved powers of the State. Id. at 435-36. In *City of El Paso v. Simmons,* The Court observed:

> The decisions "put it beyond question that the prohibition is not an absolute one and is not to be read with literal exactness like a mathematical formula," as Chief Justice Hughest said in *Home Building & Loan Assn. v. Blaisdell,* 290 U.S. 398, 428. The *Blaisdell* opinion, which amounted to a comprehensive restatement of the principles underlying the application of the Contract Clause, makes it quite clear that "[n]ot only is the constitutional provision qualified by the measure of control which the State retains over remedial processes, but the State also continues to possess authority to safeguard the vital interests of its people. It does not matter that legislation appropriate to that end 'has the result of modifying or abrogating contracts already in effect.' *Stephenson v. Binford,* 287 U.S. 251, 276. Not only are existing laws read into contracts in order to fix obligations as between the parties, but the reservation of essential attributes of sovereign power is also read into contracts as a postulate of the legal order. . . .

379 U.S. at 508.

In this case the State was not a party to the contract. The State at all relevant times reserved the right to regulate rates by statute, and it never ceded that right to the City. Permitting the Public Service Commission to set reasonable rates after notice and an opportunity for the utility to be heard does not contravene the Federal Constitution.

The decision of the district court is affirmed.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION

MINNESOTA GAS COMPANY, a Delaware corporation,
Plaintiff,

vs.

PUBLIC SERVICE COMMISSION, DEPARTMENT OF PUBLIC SERVICE, STATE OF MINNESOTA; CITY OF MINNEAPOLIS, STATE OF MINNESOTA,
Defendants.

MEMORANDUM AND ORDER
No. 4-74-Civ. 289

This action for a declaratory judgment challenges the constitutionality of § 36 of the Minnesota Public Utilities Act of 1974 (Minn. Stats. § 216B.36) insofar as it impairs the 1970 Franchise Agreement between plaintiff and the City of Minneapolis. Jurisdiction is invoked pursuant to 28 U.S.C. §§ 1331, 2201. Presently pending are motions by defendant Public Service Commission to dismiss the action for lack of subject matter jurisdiction, on abstention grounds, and for failure to state a claim upon which relief can be be granted. Oral argument on these motions was heard on November 9, 1974.

Plaintiff Minnesota Gas Company ("Minnegasco") is a Delaware corporation which distributes natural gas in

Minnesota. Minnegasco has provided gas service in the City of Minneapolis since 1870. It presently operates in Minneapolis under a Franchise Agreement with the City concluded on December 30, 1969, and effective for a 25-year period commencing January 1, 1970. The Franchise established rates to be charged in January 1970 and a mechanism for annual adjustment of rates. As a privately owned public utility Minnegasco will be subject in 1975 and thereafter to regulation of its rates and service areas by the Public Service Commission under the Public Utilities Act of 1974.

Section 36 of the Public Utilities Act expressly provides that rates and service areas determined by the Commission will supersede those in effect under existing franchises.[1] Minnegasco argues that, except in an emergency situation not present here, its Franchise with Minneapolis is invio'able. It seeks a declaration that the impairment of the Franchise by § 36 violates the Contract Clause of Art. I, § 10, and the Due Process Clause of the Fourteenth Amendment.

If the Court should uphold § 36, Minnegasco seeks in the alternative a declaration that the entire Franchise is terminated and both parties excused from all obligations thereunder.

JURISDICTION

28 U.S.C. § 2201 empowers this Court to grant a declaratory judgment "[i]n case of actual controversy

[1]The pertinent part of § 36 reads:

> "All existing . . . franchises . . . shall not be impaired or affected in any respect by the passage of this act, except with respect to matters of rate and service regulation and service area assignments that have been vested to the jurisdiction of the [public service] commission by this act."

within its jurisdiction." The Commission urges dismissal on the ground that there is no actual controversy with Minnegasco until the Commission exercises its power under the Act to alter Minnegasco's rates or areas of service. Minnegasco argues that § 36 of the Act, effective April 12, 1974, has already impaired its rights under the Franchise by depriving it of authority to set rates pursuant to the Franchise for the years 1975-1994.

There is no mechanical test for determining whether an actual case or controversy is present:

> "The difference between an abstract question and a 'controversy' contemplated by the Declaratory Judgment Act is necessarily one of degree, and it would be difficult, if it would be possible, to fashion a precise test for determining in every case whether there is such a controversy. Basically, the question in each case is whether the facts alleged, under all the circumstances, show that there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment. [Citation omitted.]" *Maryland Casualty Co. v. Pacific Co.*, 312 U.S. 270, 273 (1941).

The following cases were held to lack sufficient immediacy and reality to constitute an actual controversy: *Int'l Longshoremen's Union Local 37 v. Boyd*, 347 U.S. 222 (1954) (resident aliens who customarily traveled to Alaska for seasonal work sought a declaratory judgment against an administrative construction of a new immigration law which would treat them upon return from work in Alaska as if they were aliens seeking entry into the United States for the

first time); *Public Serv. Comm. v. Wycoff Co.*, 344 U.S. 237 (1952) (carrier sought declaration that its intrastate transportation was protected by the Commerce Clause from any possible regulation by State commission); *United Public Workers v. Mitchell*, 330 U.S. 75 (1947) (Federal employees desiring to participate in political campaigning sought declaration that Hatch Act prohibition on such activity was unconstitutional). Compare with the foregoing the following cases which the Supreme Court entertained as justiciable controversies: *Lake Carriers' Assoc. v. MacMullan*, 406 U.S. 498 (1972) (shipowners sought declaration invalidating State law requiring on-board sewage storage devices where no enforcement was to take place until land-based pump-out facilities became available); *Oregon v. Mitchell*, 400 U.S. 112 (1970) (involving, in part, action by the United States seeking declaration, prior to its effective date, that Federal law lowering voting age and otherwise overriding State electoral requirements was constitutional); *Pierce v. Society of Sisters*, 268 U.S. 510 (1925) (private schools, alleging immediate decline in enrollments, sought declaration invalidating, prior to its effective date, State law requiring children to attend public schools). Although the guidance provided by these two groups of decisions is far from clear, it seems that a justiciable controversy is presented when a new law alters, or concretely threatens to alter, a pre-existing course of conduct (e.g., dumping of sewage from ships, imposition of voting requirements by States, or operation of private schools).

In the case at bar, the Public Utilities Act of 1974 establishes new standards and mechanisms for regulating the rates and service areas of private utilities in Minnesota. Even were the Commission not to review the Minnegasco

rates for years, the presence of presumptively valid authority to do so would nonethless have substantial impact on Minnegasco's planning, financing, and dealing with suppliers. The Act concretely threatens to alter Minnegasco's present conduct of its gas distribution business in Minnesota. Since Minnegasco would thus be immediately affected by the Act and since it claims that the State has previously relinquished its authority to make any such regulations, this suit raises a justiciable controversy.

ABSTENTION

The Supreme Court has indicated that abstention is appropriate where a challenged State statute is susceptible of "a construction by the state courts that would avoid or modify the [federal] constitutional question. [Citations omitted.]" *Zwickler v. Koota,* 389 U.S. 241, 249 (1967). The Court has cautioned that the grounds for abstention must be substantial so as to justify "the delay and expense to which application of the abstention doctrine inevitably gives rise." *England v. Louisiana State Board of Medical Examiners,* 375 U.S. 411, 418 (1964). The parties agree that there is no ambiguity as to the rate-making powers granted the Commission by the Public Utilities Act. The Commission urges abstention on other grounds. It seeks a determination in State court of (1) the extent of the State's inherent police power to regulate rates, and (2) whether the State relinquished that power in granting a city charter to Minneapolis. From the exhaustive briefs submitted by the parties, it is clear that these questions have been definitively answered by the Minnesota Supreme Court. Abstention under these circumstances would serve no useful purpose. Therefore, the Court must turn to the merits of the motion to dismiss for failure to state a claim.

MOTION TO DISMISS FOR FAILURE TO STATE A CLAIM

Inherent Power to Regulate—

State ex rel Tri-State Telephone and Telegraph Co., 138 Minn. 281 (1917), upheld the power of the Legislature to override the terms of a franchise between a municipality and a telephone company in granting the Railroad and Warehouse Commission, the predecessor of the Public Service Commission, exclusive authority to license use of public streets by telephone utilities. *Tri-State* relied on the inherent power of the state to regulate utilities which serve the public (138 Minn. at 284):

> "It is quite clear to us that no vested right of the village was impaired or affected by the legislature when it undertook to interfere with the rates established in this franchise. Insofar as rates were therein fixed it was for the benefit [sic] of the public. And it is unquestioned that the legislature is supreme when it comes to prescribing or altering the rates which public service corporations may exact from their patrons. As said by Pitney, J.: 'The constitutional limitations which prevent the legislature from impairing the obligations of contracts do not debar it from annuling obligations that are due to the public.' Cortelyou v. Anderson, 73 N.J. Law, 427, 63 Atl. 1095. The regulation of public utilities is an exercise of the police power of the state and resides with the legislature."

Western States Utilities v. City of Waseca, 242 Minn. 302 (1954), again held that an inconsistent franchise provision must yield to State statute. The Court there noted:

> " ' * * * if the public interest be established the regulation of rates is one of the first forms in which it is asserted, and the validity of such regulation has been settled since Munn v. Illinois, 94 U.S. 113 [1877].' " *Western States Utilities, supra,* at 308, quoting Justice Holmes in *Black v. Hirsh,* 256 U.S. 135, 157 (1921).

Minn. Stats. §§ 300.03—300.04 are declaratory of the inherent power of the State to regulate utility rates. Section 300.03 includes in the definition of a "public service corporation" any corporation "organized for the construction, acquisition, maintenance, or operation of . . . any work for supplying the public, by whatever means, with water, light, heat, power." Section 300.04 provides in part:

> "The state shall at all times have the right to supervise and regulate the business methods and management of any such corporation and from time to time to fix the compensation which it may charge or receive for its services."

These sections were in effect in 1920 when the Charter of the City of Minneapolis was adopted and in 1969 when the present Franchise was executed.[2]

Authority Delegated by the State to Minneapolis—

Under the Home Rule provision of the Minnesota Con-

[2]Plaintiff contends that §§ 300.03 - 300.04 are limited to domestic corporations and, therefore, have no application to Minnegasco. The Court does not accept plaintiff's reading of Chapter 300, Minn. Stats., and holds that §§ 300.03 - 300.04 are fully applicable to Minnegasco's business in Minnesota. Even if the Court were to accept this construction, it would (as discussed below) still conclude that the State had inherent power to regulate the rates to Minnesota consumers.

stitution, Art. IV, § 36,[3] the City of Minneapolis adopted its present charter on November 2, 1920. The sections of the Charter which plaintiff cites as the authority for Minneapolis to enter into a binding and inviolable agreement with Minnegasco are those dealing with the general power to contract,[4] with the power to contract for erection of gas works to provide public lighting,[5] with control of the quality and measurement of gas,[6] and with control of all public ways within the city.[7] As plaintiff concedes, there is no authority in the Charter for Minneapolis to regulate utility rates.

In describing a long-term contract between a municipality and a water utility, the Minnesota Supreme Court distinguished a municipality's proprietary powers from its legislative powers:

> "The authorities are very uniform that contracts of this nature are not within the legislative or govern-

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[3]Art. IV, § 36, now repealed, provided in pertinent part: "Any city or village in this state may frame a charter for its own government as a city consistent with and subject to the laws of this state." The repeal of this section in 1958 does not imply that charters adopted under this section should no longer be interpreted as subject to the superior authority of the Legislature.

[4]"The City of Minneapolis . . . shall be capable of contracting and being contracted with, and shall have all the general powers possessed by Municipal Corporations at common law . . ." Charter, Ch. 1, § 1, at p. 1.

[5]"Tenth. — . . . to provide for the lighting of the City and contract for the erection of gas works for lighting the streets and public grounds and public buildings, ..." Charter, Ch. 4, § 5, clause 10, at p. 22.

[6]"Thirty-fifth. — To regulate and control the quality and measurement of gas; to prescribe and enforce rules and regulations for the manufacture and sale of gas; to provide for the inspection of gas and gas meters, and to appoint an inspector and other officers if needed for that purpose, and prescribe their duties." Charter, Ch. 4, § 5, clause 35, at p. 26.

[7]"The City Council shall have the care, supervision and control of all highways, streets, alleys, public squares and grounds within the limits of the city, ..." Charter, Ch. 8, § 1, at p. 54.

> mental prerogatives of the municipality, but rather within its proprietary or business powers. Their purpose is not to govern the inhabitants, but to secure for them and for itself a private benefit. [Citations omitted.]" *Reed v. City of Anoka,* 85 Minn. 294, 298 (1902).

The rate-making provisions of the Minnegasco Franchise are an exercise of Minneapolis' proprietary power. Minneapolis has no inherent legislative power to set utility rates and the State has not delegated any such power to it.

The Franchise Construed in Accordance with the Powers Remaining with the State—

" * * * Minn. Const. art. 4, § 36, expressly preserves the right of the legislature to enact general laws which are paramount to home rule charters. Monaghan v. Armatage, 218 Minn. 108, 15 N.W. (2d) 241." *Ramaley v. City of St. Paul,* 226 Minn. 406, 411 (1948). The rights and duties under the Franchise are subject to the paramount power of the State "to supervise and regulate the business methods and management of any [public service] corpora tion and from time to time to fix the compensation which it may charge or receive for its services." Minn. Stats. § 300.04. The State has exercised its reserved power in the Public Utilities Act of 1974 and any inconsistent provisions in the Franchise must yield.

Apart from § 300.04, the Court holds in the alternative that the State retains an inherent power to regulate utility rates superior to any contract power of the City. The Court subscribes fully to the rationale of the West Virginia Supreme Court in *City of Benwood v. Public Service Commission,* 83 S.E. 295 (1914). In considering a challenge to newly enacted State regulation of water rates, *Benwood*

confronted the same issue which is raised here: "May the Public Service Commission alter a rate that was fixed by franchise ordinance prior to the enactment of the law by which the commission was created and given powers?" 83 S.E. at 296. The Court in *Benwood* first affirmed the rate-making power of the State:

> "Though the grant and acceptance of the franchise wherein certain rates were fixed created a contract between the water company and the City of Benwood, the rates thereby fixed are nevertheless cognizable for revision by the Public Service Commission under the broad powers delegated thereto, unless prior to the delegation of those powers the Legislature had expressly delegated power to the City of Benwood which authorized the city to contract inviolably for the rates mentioned in the franchise for the period stated therein. Rate-making is a legislative act. It is inherent in and belongs primarily to the Legislature." *Id.*

It then examined the powers granted the City of Benwood in its charter, noting a power to erect gas works and a general power to make contracts. Relying on *Home Telephone & Telegraph v. Los Angeles,* 211 U.S. 265 (1908),[8] it held

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[8] *Benwood* cited the following passages from *Home Telephone & Telegraph:*

> "It has been settled by this court that the State may authorize one of its municipal corporations to establish by an inviolable contract the rates to be charged by a public service corporation (or natural person) for a definite term not grossly unreasonable in point of time, and that the effect of such a contract is to suspend, during the life of the contract, the governmental power of fixing and regulating the rates. * * * But for the very reason that such a contract has the effect of extinguishing pro tanto an undoubted power of government, both its existence and the authority to make it must clearly and unmistakably appear, and all doubts must be resolved in favor of the continuance of the power." *Home Telephone & Telegraph,* 211 U.S. at 273.

that there was a "presumption against exclusive delegation of the Legislature's sovereign rate-making power to a municipality." 83 S.E. at 297. It concluded that there had been no delegation "by clear and express terms" and that, therefore, "the power is reserved in the state, which can exercise it at such times and to such extent as may be found advisable." *Id.*

This Court concludes that the inherent power of the State to regulate the rates of a public utility, as well as the statute declaratory of that power, require granting the motion to dismiss the constitutional challenge for failure to state a claim upon which relief could be granted.

The Validity of the Remainder of the Franchise—

The Legislature has provided in § 36 of the Act that, except with respect to rates and service areas, existing franchises "shall not be impaired or affected in any respect by the passage of this act." As noted in *Benwood,* the city and the utility company "were bound by cognizance of the fact that their dealings were subject to future exercise of the Legislature's power over rates." 83 S.E. at 297. Since the Franchise does not provide for release of either party in the event of legislative intervention, it must be interpreted as requiring the parties to assume the risks of whatever changes the Public Service Commission may impose. This interpretation in no way offends the Contract Clause or the Due Process Clause of the Constitution. Minnegasco's alternative prayer for relief must also be dismissed for failure to state a claim.

ORDER

Accordingly, upon all the records, files, and proceedings herein,

IT IS HEREBY ORDERED:

1. That the motion of the Public Service Commission to dismiss the action for lack of subject matter jurisdiction is denied.

2. That the motion of the Public Service Commission to dismiss the action on abstention grounds is denied.

3. That the motion of the Public Service Commission to dismiss the action for failure to state a claim is granted, and plaintiff's alternative prayer for relief is dismissed.

4. That this action is dismissed.

December 12, 1974

/s/ EARL R. LARSON
United States District Judge